ECONOMIC NEWS

Mixed News on September Home Sales

New home sales rose in September. Sales of new single-family homes increase 4.8 percent last month to 770,000 units at an annual rate (see chart). That rise largely reflected a 37.7 percent jump in the West—sales in the South were flat, and sales declined in the Midwest and the Northeast. Even so, nationwide sales of new single-family homes have fallen 23.3 percent over the past 12 months. Moreover, the number of of unsold new homes remain high: at current sales rates, it would take 8.3 months to clear the current stock of unsold new homes.

New Single-Family Houses Sold

Source: Census Bureau, U.S. Department of Commerce and the National Bureau of Economic Research.
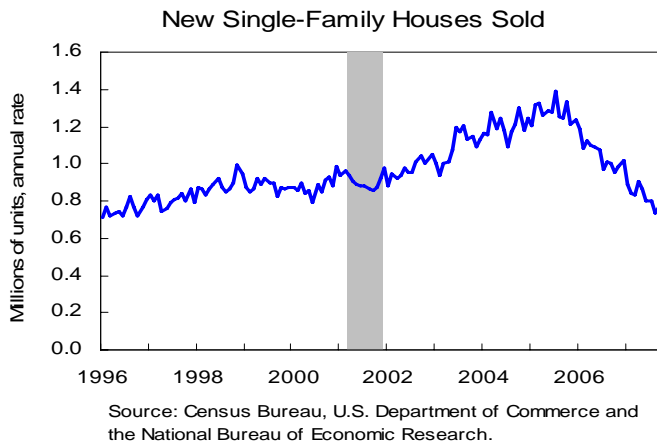
Sales of existing homes plunged last month. Total sales of existing homes (including single-family units, townhouses, condominiums, and coops) dropped by 8.0 percent in September to 5.040 million units at an annual rate. That is 19.1 percent below the level of sales a year ago. The September drop in existing home sales was pervasive: sales declined by 9.9 percent in the West (down 27.8 percent over the past year), 6.0 percent in the South (down 18.7 percent over the past year), 7.0 percent in the Midwest (down 16.2 percent over the past year), and 10.0 percent in the Northeast (down 13.5 percent over the past year).

Petroleum prices continue to rise. The spot price of domestic crude oil (West Texas intermediate) averaged nearly $90 per barrel last week. Oil prices have risen by nearly $20 a barrel since mid-August and by more than $30 per barrel (52 percent) over the past 12 months. While the retail prices for gasoline have not changed appreciably since August, whole-sale prices of home heating oil have risen sharply and are nearly 40 percent higher than at this time last year.

IN FOCUS

The Subprime Lending Crisis

The subprime mortgage lending crisis continues to be a threat to the economy. A JEC report released last week shows that subprime foreclosures over the next two years threaten staggering economic damage to households and communities across the country (The full report, *The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here*, is available online at www.jec.senate.gov). Foreclosure reduces the values of the foreclosed houses, the values of neighboring properties, and the incomes of governments that rely on property taxes.

Assuming only moderate housing price declines, the JEC estimates that more than 1.3 million subprime loans will go into foreclosure between the second half of this year and the end of 2009. Approximately $71 billion in housing wealth will be directly destroyed over that period, as each foreclosure reduces the value of the foreclosed home. Additionally, more than $32 billion dollars in housing wealth will be indirectly destroyed by the spillover effect of foreclosures, which reduce the value of neighboring properties. Finally, states will lose more than $917 million in real estate tax revenue as a result of the destruction of housing wealth caused by subprime foreclosures.

The report includes state-level estimates of subprime foreclosures and associated property losses and property tax losses, covering 2007:Q3 through 2009:Q4. Potential damages vary across states, depending on factors such as the number of subprime loans outstanding, the estimated changes in housing prices going forward, neighborhood density and tax rates. The ten states with the greatest number of estimated foreclosures, in descending order, are California, Florida, Ohio, New York, Michigan, Texas, Illinois, Arizona, Pennsylvania and Indiana (see Snapshot on next page).

Those state-level estimates rely on housing price forecasts which show moderate housing price declines. It was necessary to use these forecasts to obtain state-level results. However, it is possible that housing price declines will be substantially larger. If the aggregate the housing price decline were as much as 20 percent – which corresponds to a severe housing market downturn – the report estimates that the total number of foreclosures for the period 2007:Q1 through 2009:Q4 would be nearly 2 million, and the loss of property values would total about $106 billion.

Continued on reverse...

THE WEEK AHEAD

DAY	RELEASE

Wednesday, Oct 31
Gross Domestic Product (Third Quarter 2007, Advance)
Employment Cost Index (September 2007)
Construction Spending (September 2007)
Federal Open Market Committee statement on monetary policy

Thursday, Nov 1
Personal Income and Outlays (September 2007)

Friday, Nov 2
The Employment Situation (October 2007)
Full Report on Manufacturers' Shipments, Inventories and Orders (September 2007)

> *Wednesday Oct 31th: Fed announces its latest rate decision*

THE ECONOMY AT A GLANCE

KEY INDICATORS	MONTH			QUARTER			YEAR	
	Sep	Aug	Jul	2007 Q3	2007 Q2	2007 Q1	2006	2005
Real GDP Growth (%)	—	—	—	n.a.	3.8	0.6	2.9	3.1
Unemployment (% of labor force)	4.7	4.6	4.6	4.7	4.5	4.5	4.6	5.1
Labor Productivity Growth (%)	—	—	—	n.a.	2.6	0.7	1.0	1.9
Labor Compensation Growth (%)	—	—	—	n.a.	3.6	3.2	3.1	3.3
CPI-U Inflation (%)	3.7	-1.2	1.2	1.9	6.0	3.8	3.2	3.4
Core CPI-U Inflation (%)	2.4	2.4	2.4	2.5	1.9	2.3	2.5	2.2

Sources: Bureau of Economic Analysis, U.S. Department of Commerce; Bureau of Labor Statistics, Department of Labor.

Notes: Except where otherwise noted, values in the table represent percent changes at seasonally adjusted annual rates. Productivity is output per hour worked in private nonfarm businesses. The Employment Cost Index is for civilian workers in government and business. Core CPI-U inflation is the percent change in the CPI-U excluding food and energy as reported by the Bureau of Labor Statistics. The designation "n.a." denotes that data are not yet available.

IN FOCUS (Continued)

These problems have evolved because, in the subprime mortgage market, the economic incentives of mortgage originators and lenders work against the interests of borrowers. Most subprime loans are originated by mortgage brokers. But since mortgage brokers bear little or no risk when a borrower defaults, they have no economic incentive to originate loans that a borrower can afford in the long term. Most subprime mortgages are funded by mortgage companies, rather than deposit-taking institutions subject to more stringent regulation. Because mortgage companies sell many of the loans they underwrite to the secondary market, they have had a strong incentive to underwrite high-yielding subprime mortgages, whether or not these loans were best interests of the borrowers. These incentives have led to the rapid expansion of subprime lending, and to the widespread use of potentially abusive or predatory mortgage contracts.

As a result, in addition to the damages to households and communities, the financial markets remain at risk. Just last week Merrill Lynch, a major issuer of securities backed by subprime loans, and a large scale holder of collateralized debt obligations based on subprimes, announced a $7.9 billion dollar write-down of assets previously valued at $28.8 billion. Standard & Poor's described the loss as "staggering." More write-downs by other financial institutions are expected.

The Treasury has been forced to coordinate the creation of a so-called "super-conduit" – a privately funded vehicle intended to buy securities backed by subprime loans and other assets that are held off-balance-sheet by banks. Many of these off-balance-sheet assets have declined in value, because the wretched prospects for subprime loans are now clear. But no one is certain exactly how much value the banks have lost, because trading in these securities has fallen dramatically. The hope is that the super-conduit can avert a fire sale of these assets, and prevent an immediate and massive loss for the banks. Many financial market participants remain skeptical of the super-conduit's success.

Projected Economic Costs of the Subprime Mortgage Crisis State-by-State
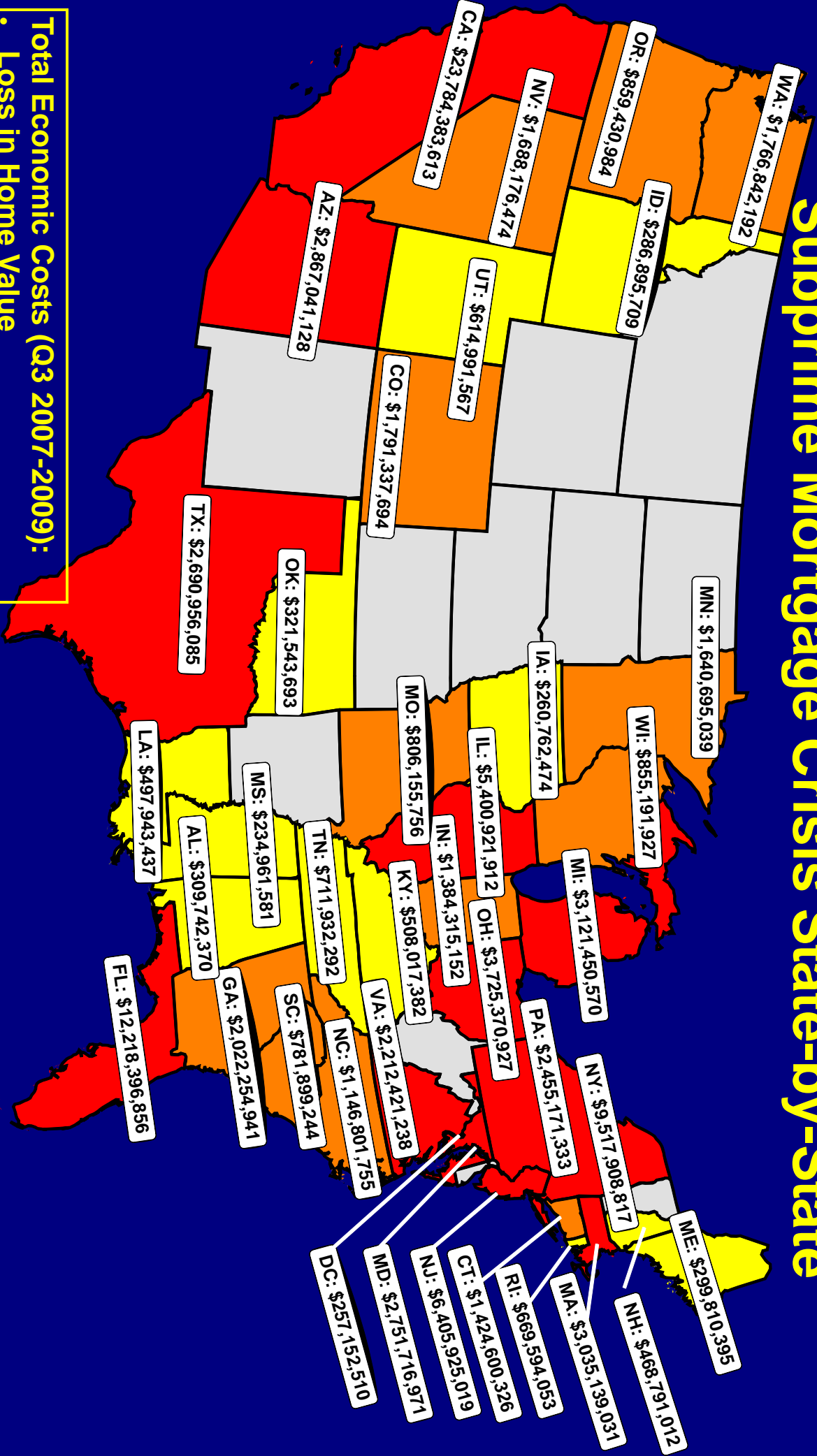
Total Economic Costs (Q3 2007-2009):
- Loss in Home Value
- Loss in Neighboring Property Values
- Loss in Property Tax Revenues

Source: JEC Calculations.

Legend:
- $13 Million to $230 Million
- $230 Million to $740 Million
- $740 Million to $2.2 Billion
- $2.2 Billion to $24 Billion

State values:
- WA: $1,766,842,192
- OR: $859,430,984
- CA: $23,784,383,613
- NV: $1,688,176,474
- ID: $286,895,709
- AZ: $2,867,041,128
- UT: $614,991,567
- CO: $1,791,337,694
- TX: $2,690,956,085
- OK: $321,543,693
- MN: $1,640,695,039
- IA: $260,762,474
- WI: $855,191,927
- MO: $806,155,756
- IL: $5,400,921,912
- IN: $1,384,315,152
- MI: $3,121,450,570
- LA: $497,943,437
- MS: $234,961,581
- AL: $309,742,370
- TN: $711,932,292
- KY: $508,017,382
- OH: $3,725,370,927
- PA: $2,455,171,333
- NY: $9,517,908,817
- FL: $12,218,396,856
- GA: $2,022,254,941
- SC: $781,899,244
- NC: $1,146,801,755
- VA: $2,212,421,238
- DC: $257,152,510
- MD: $2,751,716,971
- NJ: $6,405,925,019
- CT: $1,424,600,326
- RI: $669,594,053
- MA: $3,035,139,031
- NH: $468,791,012
- ME: $299,810,395